

(9)	New Entrants	For purposes of the forecast, new entrants were added to maintain a stable population. Average hire age is 31. Average salary at hire increases 5%
(10)	Annual Per Capita Cost for 1993	\$510
(11)	Administrative Expenses	None
(12)	Annual AT&T Reimbursement	\$140; no escalation
(13)	Participants Assumed to Live Outside the Service Area of SBC	17.5%

**SBC POSTRETIREMENT TELEPHONE CONCESSIONS VALUATION**  
**Basic Valuation Results – SB Telephone Company**  
**(\$000)**

<u>Year</u>	<u>Claims</u>	<u>EPBO</u>	<u>APBO</u>	<u>Assets</u>	<u>Service Cost</u>	<u>Expense</u>	<u>Expense as % of Payroll</u>
1993	\$2,398	\$47,847	\$42,023	\$0	\$702	\$3,818 *	0.22%
1994	2,441	49,037	43,442	0	725	3,948	0.21%
1995	2,485	50,294	44,951	0	735	4,070	0.21%
1996	2,535	51,620	46,536	0	750	4,203	0.21%
1997	2,592	53,013	48,205	0	744	4,320	0.21%
1998	2,661	54,468	49,933	0	737	4,439	0.21%
1999	2,747	55,980	51,711	0	682	4,510	0.20%
2000	2,858	57,541	53,474	0	637	4,590	0.20%
2001	2,991	59,134	55,205	0	605	4,681	0.20%
2002	3,140	60,736	56,895	0	579	4,774	0.20%
2003	3,303	62,333	58,529	0	551	4,860	0.20%
2004	3,485	63,910	60,084	0	514	4,931	0.19%
2005	3,683	65,448	61,530	0	461	4,975	0.19%
2006	3,890	66,926	62,821	0	469	5,073	0.19%
2007	4,100	68,325	64,004	0	423	5,104	0.19%
2008	4,310	69,635	65,009	0	441	5,191	0.18%
2009	4,519	70,846	65,890	0	427	5,234	0.18%
2010	4,730	71,951	66,605	0	426	5,279	0.18%
2011	4,930	72,937	67,154	0	451	5,340	0.17%
2012	5,115	73,800	67,563	0	483	5,398	0.17%

\* Excludes Transition Obligation expense of \$ 42,023,000 taken in 1993

# **Distribution of SFAS-106 Costs to Part 32 Accounts**

**Southwestern Bell Telephone Company**  
**Distribution of SFAS 106 Costs to**  
**Part 32 Accounts**  
**1993**

<b><u>Part 32</u></b>		<b><u>SFAS 106</u></b>
<b><u>Account</u></b>	<b><u>Account Title</u></b>	<b><u>Distribution</u></b>
1320	Prepaid Directory Expenses	0.11%
1439	Deferred Charges	0.08%
6112	Motor Vehicle Expense	0.07%
6115	Garage Work Eqpt Expense	0.00%
6116	Other Work Eqpt Expense	0.02%
6121	Land and Building Expense	0.84%
6122	Furniture and Artworks Expense	0.01%
6123	Office Eqpt Expense	0.53%
6124	General Purpose Computer Expense	2.31%
6211	Analog Electr. Expense	2.44%
6212	Digital Electr. Expense	2.62%
6220	Operator Systems Expense	0.05%
6231	Radio Systems Expense	0.10%
6232	Circuit Eqpt Expense	2.72%
6311	Station Apparatus Expense	0.03%
6341	Large PBX Expense	0.07%
6351	Pub Tel Terminal Eqpt Expense	0.62%
6362	Other Terminal Eqpt Expense	5.42%
6411	Poles Expense	0.08%
6421	Aerial Cable Expense	4.89%
6422	Underground Cable Expense	1.00%
6423	Buried Cable Expense	9.20%
6424	Submarine Cable Expense	0.00%
6426	Intrabuilding Network Cable Expense	0.01%
6431	Aerial Wire Expense	0.02%
6441	Conduit Systems Expense	0.02%
6512	Provisioning Expense	0.06%
6532	Network Adminsitration Expense	2.41%
6533	Testing Expense	5.44%
6534	Plant Opns Admin Expense	3.91%
6535	Engineering Expense	3.27%
6611	Product Management	1.20%
6612	Sales	4.22%
6613	Product Advertising	0.12%

**Part 32****Account****Account Title****SFAS 106****Distribution**

6621	Call Completion Services	2.80%
6622	Number Services	5.40%
6623	Customer Services	13.99%
6711	Executive	0.64%
6712	Planning	0.22%
6721	Accounting and Finance	1.72%
6722	External Relations	2.11%
6723	Human Resources	1.85%
6724	Information Management	3.28%
6725	Legal	0.53%
6726	Procurement	0.65%
6728	Other General and Admin	2.00%
7370	Special Charges	0.26%
9708	Custom Work	0.22%
2111	Land	0.00%
2116	Other Work Eqpt	0.00%
2121	Buildings	0.12%
2124	General Purpose Computers	0.00%
2123	Office Eqpt	0.16%
2211	Analog Electronic Switching	0.14%
2212	Digital Electronic Switching	0.69%
2215	Electro–Mech Electr Switching	0.03%
2220	Operator Systems	0.01%
2231	Radio Systems	0.01%
2232	Circuit Eqpt	1.47%
2341	Large PBX	0.02%
2351	Pub Tel Terminal Eqpt	0.02%
2362	Other Terminal Eqpt	0.31%
2411	Poles	0.15%
2421	Aerial Cable	1.14%
2422	Underground Cable	0.90%
2423	Buried Cable	3.57%
2426	Intrabuilding Network Cable	0.02%
2431	Aerial Wire	0.02%
2441	Conduit Systems	0.12%
2682	Leasehold Improvements	0.01%
3100	Accumulated Depreciation	<u>1.52%</u>
		<u>100.00%</u>

**Justification of Allocations for  
Removal of Nonregulated and Excluded  
Services and Allocation to Price  
Cap Baskets**

**Allocation of Dollar Amounts**

**OPEB Designation Order, Paragraph 20, Issue C, Item 6  
(Allocation of SFAS-106 costs to baskets)**

	1993 <u>OPEB TBO</u>					
	<u>CL</u>	<u>TS</u>	<u>SPECIAL</u>	<u>TRUNK</u>	<u>IX</u>	<u>TOTAL</u>
TOTAL IS*	\$17.932M	\$14.076M	\$4.646M	0	\$1.997M	\$38.651M
BEFORE LT RESTRUCTURE	\$15.084M	\$11.934M	\$3.935M	0	\$1.691M	\$32.644M
AFTER LT RESTRUCTURE	\$15.084M	\$ 5.966M	0	\$9.903M	\$1.691M	\$32.644M

SOURCE: 1993 Annual Filing Transmittal 2271 D&J Page 2-18

\* Prior to reduction for price cap excluded services and Godwins adjustment (15.2%)

NOTE: SWBT modified its PCIs effective 10/16/94 by letter dated 9/1/94 to  
Mr. William Caton to include the additional ongoing SFAS-106 costs as follows.

Common Line	\$3.639M
Traffic Sensitive	\$1.440M
Trunking	\$2.389M
Interexchange	<u>\$ .408M</u>
Total	\$7.876M

**Justification of Allocations for  
Removal of Nonregulated and Excluded  
Services and Allocation to Price  
Cap Baskets**

**Documentation from SWBT's 1993  
Annual Access Tariff Filing**



## 2.G SFAS 106 (OPEB)

This section describes how SWBT calculated the exogenous cost impact associated with the TBO portion of the SFAS 106 accounting change. The discussion of the justification for inclusion of this impact as an exogenous cost is contained in Section 3.

### INCREMENTAL OPEB TBO COST

The accrual amounts associated with SFAS 106 for SWBT were determined by an actuarial valuation completed by Towers, Perrin, Forster and Crosby (TPF&C). This study quantified the total OPEB cost by year for a 20 year period. The study quantified estimated claims, Expected Post Retirement Benefit Obligation (EPBO), Accumulated Post Retirement Benefit Obligation (APBO), dedicated assets available to pay claims, service cost and total OPEB cost. SWBT proposes the use of a 16 year average remaining service life to amortize the TBO portion of the total OPEB cost.

For this filing, SWBT is requesting exogenous treatment of the TBO which represents costs associated with retirees and active employees. These amounts were actuarially determined by TPF&C in a study dated May 22, 1992. For this filing SWBT has developed its SFAS 106 OPEB cost in the following manner. Amortization of the TBO was added to the 1993 interest cost related to the January 1, 1993 APBO (1993 service cost was not included in this computation). The sum of the TBO amortization and the interest was reduced by the earnings on plan assets. The resultant figure is identified as SFAS 106 cost. Determination of the incremental OPEB cost is shown below.

SFAS 106 Cost	\$387,300,000
Estimated OPEB (Pay-as-you go)	<u>143,600,000</u>
Incremental OPEB Cost	<u>\$108,100,000</u>

The incremental OPEB cost was categorized in the following manner prior to the application of Part 64 and Part 36 Separations Rules.

The amounts were allocated to the various account categories based on percentages derived from the actual distribution of total company benefits through the Benefits Clearing Process.

A portion of the total SFAS 106 TBO cost was assumed to be capitalized as part of the Company's telephone plant in service (Account 2001) and other investment related accounts. The amount capitalized was subtracted from incremental SFAS 106 TBO cost to arrive at net OPEB cost..

The remaining amount was considered to be the incremental SFAS 106 expense to which depreciation expense related to the above mentioned telephone plant in service was added to arrive at the total incremental expense impact. In calculating depreciation expense the Company assumed a 6% annual composite depreciation rate and utilized the one half in year of acquisition convention.

The incremental rate base impact was calculated in the following manner.

The mid-year OPEB liability was considered to be a reduction from the rate base. Additionally, the mid-year OPEB related depreciation reserves and deferred tax amounts increased to the rate base because they represent debit balances.

The authorized interstate rate of return (11.25%) and a tax gross-up factor were applied to the incremental change in the rate base to arrive at the incremental revenue requirement impact related to rate base.

The following summarizes the 1993 incremental impacts of SFAS 106 for total SWBT for the expense components.

Total operating expense	\$200,300,000
Depreciation expense	<u>1,300,000</u>
Total incremental expense impact	<u>\$201,600,000</u>

The following summarizes the 1993 incremental impacts of SFAS 106 for total SWBT for the rate base components. Rate base amounts are as of mid-year.

Account 4310 - OPEB liability	(\$121,800,000)
Total plant in service	13,000,000
Related depreciation reserves	2,800,000
Short term PUC	3,450,000
Long term PUC	1,850,000
Deferred taxes	<u>35,000,000</u>
Total incremental rate base impact	<u>(\$65,700,000)</u>

#### DETERMINATION OF SUBJECT TO SEPARATION INCREMENTAL OPEB TBO COST

To quantify the incremental interstate regulated impacts, SWBT separated the incremental costs by study area and excluded amounts associated with nonregulated and other categories (i.e., SNFA and affiliate transactions). The result is the subject to separations incremental costs.

The incremental OPEB costs are shown by study area on Workpaper 1. The study area costs were developed based upon historical distribution factors derived from SWBT's 1992 43-01 ARMIS Quarterly Report. See Workpaper 2.

Workpaper 3 shows the development of the subject to separations costs. Except for Plant Under Construction amounts, nonregulated and other cost amounts were developed based upon historical distribution factors derived from SWBT's 1992 43-01 data. Plant Under Construction amounts were based upon factors derived from SWBT's 1992 43-03 ARMIS Regulated/Nonregulated data. See Workpaper 4.

To jurisdictionally apportion costs, it was necessary to determine the impacts for each of the categories contained in the Part 36 separations rules. 1992 annual data were used as the basis for developing factors to expand the subject to separations amounts, shown on Workpaper 3, into the Part 36 separations categories.

#### INTERSTATE AND ACCESS OPEB TBO COST IMPACTS

SWBT's modified base year data was revised to include the OPEB TBO incremental costs and input into SWBT's ICAS system and processed through the Part 36 and Part 69 allocations. The resulting Part 36 interstate and Part 69 access cost amounts are summarized on Figure 2G-1. Figures 2G-2 through 2G-6 display the associated amounts for SWBT's study areas.

Figure 2G-1.1 summarizes the impact associated with the additional OPEB TBO Costs\*. Figures 2G-2.1 through 2G-2.6-1 display OPEB TBO Cost Impacts for SWBT's study areas.

#### OPEB TBO COST ADJUSTMENTS

Additional adjustments were required for the calculation of the OPEB exogenous cost change.

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\*Amounts shown on Figure 2G-1.1 are the differences between the amounts shown on Figure 2G-1 and Figure 2A-1.

SWBT applied an 84.8 percent factor to the price cap services exogenous cost to derive the portion of costs that will not be recovered through the price cap inflation adjustment or wage rate mechanisms (See Section 3C). These adjustments and the 1993 OPEB TBO exogenous cost change by price cap basket are shown in the Table below.

**TABLE**

	OPEB TBO Impact (Figure 2G-1.1) (A)	Svcs. Adj. (B**)	EXCL. Godwins Adjustment (C)	Exogenous Cost with Godwins Adj. (D=A*B*C)
Common Line	\$ 17.932M	.991950	.848	\$ 15.084
Traffic Sensitive	\$ 14.076M	.999787	.848	\$ 11.034
Special Access	\$ 4.646M	.998786	.848	\$ 3.935
Interexchange	\$ 1.997M	.998382	.848	\$ 1.691
Total Access & IX	\$ 38.651M			\$ 32.644

Since the revised PCIs and rates reflecting the OPEB adjustment are proposed to become effective on July 1, 1993, an exogenous cost amount of \$65.288 million was used to adjust the basket PCIs. This adjustment is required to recover the total OPEB cost during the remaining period of 1993. On January 1, 1994, \$32.644 million of the exogenous cost will be reversed.

The \$65.288 million is distributed to the price cap baskets on follows:

		<u>Percent</u>
Common Line	\$30.168	46.21%
Traffic Sensitive	\$23.868	36.56%
Special Access	\$ 7.870	12.05%
Interexchange	\$ 3.382	5.18%
Total Access & IX	\$65.288	100.00%

\*\*See Figure 2H-7 for development of the factors by basket to calculate the portion of costs related to nonprice cap services. The ratio shown herein represents 1 less the nonprice cap services ratio for each basket.

1993 IMPACT OF SFAS 106 \* TBO BY  
STUDY AREA

	TOTAL SWBT	ARKANSAS	KANSAS	MISSOURI	OKLAHOMA	TEXAS
1. TOTAL OPERATING EXP	200,300,000	11,220,993	16,893,728	26,780,628	18,761,604	126,643,047
2. DEPR EXPENSE	1,300,000	89,146	112,239	234,532	129,572	734,511
3. ACCOUNT 4310	121,800,000	6,823,350	10,272,871	16,284,975	11,408,704	77,010,100
4. TOTAL PLANT IN SERVICE	13,000,000	858,229	1,044,530	2,268,494	1,350,817	7,477,930
5. SHORT TERM PUC	3,450,000	127,783	543,764	502,365	438,446	1,839,642
6. LONG TERM PUC	1,850,000	111,657	186,326	433,520	336,467	782,030
7. DEPR RESERVES	(2,800,000)	(191,253)	(220,686)	(412,740)	(316,061)	(1,659,259)
8. DEFERRED TAXES	(35,000,000)	(2,195,011)	(2,932,884)	(6,392,072)	(3,527,832)	(19,952,201)

\* SFAS-106 AMOUNTS WERE DISTRIBUTED TO SWBT'S STUDY AREAS BASED ON RATIOS FROM SWBT'S JANUARY THROUGH DECEMBER, 1992 43-01 AND 43-03 ARMIS REPORTS. SEE WORKPAPER 2.

**DISTRIBUTION FACTORS FOR  
EXPENSE, INVESTMENT, LIABILITY - SFAS 106**

(000)

<b>HISTORIC INPUT</b>	<b>TOTAL SWBT</b>	<b>ARKANSAS</b>	<b>KANSAS</b>	<b>MISSOURI</b>	<b>OKLAHOMA</b>	<b>TEXAS</b>
1. TOT OPER EXP EXCL DEPR	4,695,459	263,044	396,025	627,795	439,812	2,968,783
2. DEPR EXPENSE	1,593,031	109,240	137,539	287,397	158,779	900,076
3. ACCOUNT 4310	4,695,459	263,044	396,025	627,795	439,812	2,968,783
4. TOTAL PLANT IN SERVICE	24,907,414	1,644,328	2,001,273	4,346,333	2,588,104	14,327,376
5. SHORT TERM PUC	162,506	6,019	25,613	23,663	20,558	86,653
6. LONG TERM PUC	98,931	5,971	9,964	23,183	17,993	41,820
7. DEPR RESERVES	10,086,188	688,935	794,958	1,486,777	1,138,517	5,977,001
8. DEFERRED TAXES	2,794,597	175,262	234,178	510,379	281,682	1,593,096

<b>ARMIS 43-01 DISTRIBUTION FACTORS*</b>	<b>TOTAL SWBT</b>	<b>ARKANSAS</b>	<b>KANSAS</b>	<b>MISSOURI</b>	<b>OKLAHOMA</b>	<b>TEXAS</b>
9. TOT OPER EXP EXCL DEPR	1.000000	0.056021	0.084342	0.133703	0.093668	0.632267
10. DEPR EXPENSE	1.000000	0.068574	0.086338	0.180409	0.099671	0.565006
11. ACCOUNT 4310	1.000000	0.056021	0.084342	0.133703	0.093668	0.632267
12. TOTAL PLANT IN SERVICE	1.000000	0.066018	0.080348	0.174500	0.103909	0.575225
13. SHORT TERM PUC	1.000000	0.037039	0.157613	0.145613	0.128506	0.533230
14. LONG TERM PUC	1.000000	0.060355	0.100717	0.234335	0.181874	0.422719
15. DEPR RESERVES	1.000000	0.068305	0.078816	0.147407	0.112879	0.592593
16. DEFERRED TAXES	1.000000	0.062715	0.083797	0.182631	0.100795	0.570063

**\*SOURCING FOR INPUT USING 1992 DATA**

1. TOT OPER EXP EXCL DEPR	ARMIS 43-01 LN 1190 - LN 1180
2. DEPR EXPENSE	ARMIS 43-01 LN 1180
3. ACCOUNT 4310	ARMIS 43-01 LN 1190 - LN 1180
4. TOTAL PLANT IN SERVICE	ARMIS 43-01 LN 1690
5. SHORT TERM PUC	ARMIS 43-03 LN 2003
6. LONG TERM PUC	ARMIS 43-03 LN 2004
7. DEPR RESERVES	ARMIS 43-01 LN 1820
8. DEFERRED TAXES	ARMIS 43-01 LN 1840

DEVELOPMENT OF 1993 SUBJECT TO SEPARATIONS  
EXPENSE, INVESTMENT, LIABILITY – SFAS 106 TBO

WORKPAPER 3

	(A)	(B)	(C)	(D=A-B-C)
TOTAL SWBT	TOTAL	NONREG	OTHER	SUB TO SEP
1. TOTAL OPER EXP EXCL DEPR	200,300,000	6,263,338	1,320,784	192,715,877
2. DEPR EXPENSE	1,300,000	1,358	476	1,298,167
3. ACCOUNT 4310	121,800,000	3,808,660	803,153	117,188,187
4. TOTAL PLANT IN SERVICE	13,000,000	217,938	1,477,596	11,304,466
5. SHORT TERM PUC	3,450,000	16	(14,250)	3,464,234
6. LONG TERM PUC	1,850,000	2	(5,281)	1,855,279
7. DEPR RESERVES	(2,800,000)	(16,376)	(179,120)	(2,604,505)
8. DEFERRED TAXES	(35,000,000)	(71,446)	(377,639)	(34,550,915)

	(A)	(B)	(C)	(D=A-B-C)
ARKANSAS	TOTAL	NONREG	OTHER	SUB TO SEP
1. TOTAL OPER EXP EXCL DEPR	11,220,993	289,948	46,967	10,884,078
2. DEPR EXPENSE	89,146	70	21	89,055
3. ACCOUNT 4310	6,823,350	176,314	28,560	6,618,476
4. TOTAL PLANT IN SERVICE	858,229	10,454	99,234	748,541
5. SHORT TERM PUC	127,783	0	(7,824)	135,607
6. LONG TERM PUC	111,657	0	(1,072)	112,729
7. DEPR RESERVES	(191,253)	(837)	1,354	(191,770)
8. DEFERRED TAXES	(2,195,011)	(3,513)	(12,133)	(2,179,364)

	(A)	(B)	(C)	(D=A-B-C)
KANSAS	TOTAL	NONREG	OTHER	SUB TO SEP
1. TOTAL OPER EXP EXCL DEPR	16,893,728	366,562	150,456	16,376,710
2. DEPR EXPENSE	112,239	78	86	112,075
3. ACCOUNT 4310	10,272,871	222,902	91,490	9,958,479
4. TOTAL PLANT IN SERVICE	1,044,530	14,694	149,820	880,017
5. SHORT TERM PUC	543,764	0	15,286	528,477
6. LONG TERM PUC	186,326	0	(1,910)	188,236
7. DEPR RESERVES	(220,686)	(1,082)	(15,898)	(203,706)
8. DEFERRED TAXES	(2,932,884)	(4,680)	(40,117)	(2,888,087)

	(A)	(B)	(C)	(D=A-B-C)
MISSOURI	TOTAL	NONREG	OTHER	SUB TO SEP
1. TOTAL OPER EXP EXCL DEPR	26,780,628	793,784	631,811	25,355,032
2. DEPR EXPENSE	234,532	438	128	233,966
3. ACCOUNT 4310	16,284,975	482,691	384,197	15,418,087
4. TOTAL PLANT IN SERVICE	2,268,494	75,340	384,303	1,808,851
5. SHORT TERM PUC	502,385	1	(2,703)	505,067
6. LONG TERM PUC	433,520	1	2,534	430,984
7. DEPR RESERVES	(412,740)	(3,901)	(11,416)	(397,423)
8. DEFERRED TAXES	(6,392,072)	(24,640)	(139,623)	(6,227,809)

	(A)	(B)	(C)	(D=A-B-C)
OKLAHOMA	TOTAL	NONREG	OTHER	SUB TO SEP
1. TOTAL OPER EXP EXCL DEPR	18,761,604	588,897	62,324	18,110,384
2. DEPR EXPENSE	129,572	153	34	129,386
3. ACCOUNT 4310	11,408,704	358,101	37,898	11,012,705
4. TOTAL PLANT IN SERVICE	1,350,817	23,477	145,174	1,182,166
5. SHORT TERM PUC	436,446	5	(6,437)	442,878
6. LONG TERM PUC	336,467	0	(1,162)	337,629
7. DEPR RESERVES	(316,061)	(2,290)	(19,899)	(293,871)
8. DEFERRED TAXES	(3,527,832)	(7,187)	(85,218)	(3,435,428)

	(A)	(B)	(C)	(D=A-B-C)
TEXAS	TOTAL	NONREG	OTHER	SUB TO SEP
1. TOTAL OPER EXP EXCL DEPR	126,643,047	4,224,147	429,227	121,989,673
2. DEPR EXPENSE	734,511	619	207	733,685
3. ACCOUNT 4310	77,010,100	2,568,652	261,008	74,180,440
4. TOTAL PLANT IN SERVICE	7,477,930	93,973	699,065	6,684,891
5. SHORT TERM PUC	1,839,642	11	(12,572)	1,852,203
6. LONG TERM PUC	782,030	0	(3,671)	785,701
7. DEPR RESERVES	(1,659,259)	(8,265)	(133,260)	(1,517,734)
8. DEFERRED TAXES	(19,952,201)	(31,426)	(100,548)	(19,820,227)

SOURCES

COLUMN A = WORKPAPER 1

COLUMN B = COLUMN A \* NONREG RATIO, WORKPAPER 4, COLUMN B

COLUMN C = COLUMN A \* OTHER RATIO, WORKPAPER 4, COLUMN C

COLUMN D = COLUMN A - COLUMN B - COLUMN C



DEVELOPMENT OF SUBJECT TO SEPARATIONS  
EXPENSE, INVESTMENT, LIABILITY RATIOS—SFAS 106

WORKPAPER 4

ARKANSAS	RATIOS			1991 ACTUALS (000)		
	(A) TOTAL	(B) NONREG	(C) OTHER	(D) TOTAL	(E) NONREG	(F) OTHER
1. TOTAL OPER EXP EXCL DEPR	1.000000	0.025840	0.004186	263.044	6,797	1,101
2. DEPR EXPENSE	1.000000	0.000791	0.000232	109,240	208	61
3. ACCOUNT 4310	1.000000	0.025840	0.004186	263.044	6,797	1,101
4. TOTAL PLANT IN SERVICE	1.000000	0.012180	0.115627	1,644,328	3,204	30,415
5. SHORT TERM PUC	1.000000	0.000000	-0.061229	11,016	0	(16,106)
6. LONG TERM PUC	1.000000	0.000000	-0.008903	6,512	0	(2,526)
7. DEPR RESERVES	1.000000	0.004376	-0.007079	688,935	1,151	(1,862)
8. DEFERRED TAXES	1.000000	0.001600	0.005528	175,262	421	1,454

  

KANSAS	RATIOS			1991 ACTUALS (000)		
	(A) TOTAL	(B) NONREG	(C) OTHER	(D) TOTAL	(E) NONREG	(F) OTHER
1. TOTAL OPER EXP EXCL DEPR	1.000000	0.021698	0.008906	396.025	8,593	3,527
2. DEPR EXPENSE	1.000000	0.000897	0.000765	137,539	276	303
3. ACCOUNT 4310	1.000000	0.021698	0.008906	396.025	8,593	3,527
4. TOTAL PLANT IN SERVICE	1.000000	0.014067	0.143433	2,001,273	5,571	56,803
5. SHORT TERM PUC	1.000000	0.000000	0.028112	12,738	0	11,133
6. LONG TERM PUC	1.000000	0.000000	-0.010249	8,417	0	(4,059)
7. DEPR RESERVES	1.000000	0.004904	0.072038	794,958	1,942	28,529
8. DEFERRED TAXES	1.000000	0.001596	0.013678	234,178	632	5,417

  

MISSOURI	RATIOS			1991 ACTUALS (000)		
	(A) TOTAL	(B) NONREG	(C) OTHER	(D) TOTAL	(E) NONREG	(F) OTHER
1. TOTAL OPER EXP EXCL DEPR	1.000000	0.029640	0.023592	627,795	18,608	14,811
2. DEPR EXPENSE	1.000000	0.001867	0.000545	287,397	1,172	342
3. ACCOUNT 4310	1.000000	0.029640	0.023592	627,795	18,608	14,811
4. TOTAL PLANT IN SERVICE	1.000000	0.033211	0.188409	4,346,333	20,850	106,354
5. SHORT TERM PUC	1.000000	0.000002	-0.006381	23,123	1	(3,378)
6. LONG TERM PUC	1.000000	0.000003	0.005846	23,868	2	3,670
7. DEPR RESERVES	1.000000	0.008452	0.027659	1,486,777	5,934	17,364
8. DEFERRED TAXES	1.000000	0.003855	0.021843	510,379	2,420	13,713

  

OKLAHOMA	RATIOS			1991 ACTUALS (000)		
	(A) TOTAL	(B) NONREG	(C) OTHER	(D) TOTAL	(E) NONREG	(F) OTHER
1. TOTAL OPER EXP EXCL DEPR	1.000000	0.031388	0.003322	439,812	13,805	1,461
2. DEPR EXPENSE	1.000000	0.001178	0.000261	158,779	518	115
3. ACCOUNT 4310	1.000000	0.031388	0.003322	439,812	13,805	1,461
4. TOTAL PLANT IN SERVICE	1.000000	0.017380	0.107471	2,588,104	7,644	47,267
5. SHORT TERM PUC	1.000000	0.000011	-0.014749	20,783	5	(6,487)
6. LONG TERM PUC	1.000000	0.000000	-0.003484	11,722	0	(1,519)
7. DEPR RESERVES	1.000000	0.007246	0.062961	1,138,517	3,187	27,691
8. DEFERRED TAXES	1.000000	0.002037	0.024156	281,682	896	10,624

  

TEXAS	RATIOS			1991 ACTUALS (000)		
	(A) TOTAL	(B) NONREG	(C) OTHER	(D) TOTAL	(E) NONREG	(F) OTHER
1. TOTAL OPER EXP EXCL DEPR	1.000000	0.033355	0.003389	2,968,783	99,023	10,062
2. DEPR EXPENSE	1.000000	0.000842	0.000282	900,076	2,500	838
3. ACCOUNT 4310	1.000000	0.033355	0.003389	2,968,783	99,023	10,062
4. TOTAL PLANT IN SERVICE	1.000000	0.012567	0.083484	14,327,376	37,308	277,533
5. SHORT TERM PUC	1.000000	0.000006	-0.008834	86,749	17	(20,288)
6. LONG TERM PUC	1.000000	0.000000	-0.004694	63,441	1	(13,936)
7. DEPR RESERVES	1.000000	0.004961	0.080313	5,977,001	14,788	238,432
8. DEFERRED TAXES	1.000000	0.001575	0.006039	1,593,096	4,676	14,961

\*SOURCING FOR INPUT USING 1992 DATA

1. TOTAL OPER EXP EXCL DEPR	ARMS 43-01 LN 1190 - LN 1180
2. DEPR EXPENSE	ARMS 43-01 LN 1180
3. ACCOUNT 4310 (OPER EXP EXCL DEPR)	ARMS 43-01 LN 1190 - LN 1180
4. TOTAL PLANT IN SERVICE	ARMS 43-01 LN 1690
5. SHORT TERM PUC	ARMS 43-03 LN 2003
6. LONG TERM PUC	ARMS 43-03 LN 2004
7. DEPR RESERVES	ARMS 43-01 LN 1820
8. DEFERRED TAXES	ARMS 43-01 LN 1840

**U.S. District of Columbia  
Court of Appeals Remand of  
the Commission's January 22, 1993  
OPEB Order**

Notice: This opinion is subject to formal revision before publication in the Federal Reporter or U.S.App.D.C. Reports. Users are requested to notify the Clerk of any formal errors in order that corrections may be made before the bound volumes go to press.

## United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

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Argued May 19, 1994

Decided July 12, 1994

No. 93-1168

SOUTHWESTERN BELL TELEPHONE COMPANY, ET AL.,  
PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION AND  
UNITED STATES OF AMERICA  
RESPONDENTS

UNITED STATES TELEPHONE ASSOCIATION, ET AL.,  
INTERVENORS

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And consolidated Nos. 93-1185, 93-1218

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Appeal from an Order of the Federal  
Communications Commission

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*John Gibson Mullan* argued the cause for petitioners. With him on the briefs of petitioners and supporting intervenors were *Robert M. Lynch*, *Richard C. Hargrove*, *Thomas*

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Bills of costs must be filed within 14 days after entry of judgment. The court looks with disfavor upon motions to file bills of costs out of time.

*A. Pajda, M. Robert Sutherland, Lawrence W. Katz, Mary McDermott, Richard McKenna, Robert B. McKenna, Michael J. Shortley, III, John W. Bogy, Kathleen A. Carrigan and Linda L. Kent.*

*Laurel R. Bergold*, Counsel, Federal Communication Commission, argued the cause for respondents. With her on the brief were *William E. Kennard*, General Counsel, *Daniel M. Armstrong*, Associate General Counsel, *John E. Ingle*, Deputy Associate General Counsel, *C. Grey Pash, Jr.*, Counsel, Federal Communications Commission, *Anne K. Bingaman*, Assistant Attorney General, *Robert B. Nicholson* and *Robert J. Wiggers*, Attorneys, United States Department of Justice.

On the brief for intervenors were *John M. Glynn*, *Robert L. Duston*, and *Gary L. Lieber* for Maryland People's Counsel, *Brian R. Moir* for International Communications Association, and *Frank W. Krogh* and *Donald J. Elardo* for MCI Telecommunications Corporation.

*Alfred W. Whittaker* entered an appearance for petitioner Southwestern Bell Telephone Company. *William B. Barfield* entered an appearance for petitioner BellSouth Corporation. *Michael D. Lowe* entered an appearance for petitioner Bell Atlantic Telephone Companies. *Saul Fisher* entered an appearance for petitioner New York Telephone Company.

*James L. Wurtz*, *Margaret deB. Brown* and *James P. Tuthill* entered an appearance for intervenor Pacific Bell. *Marc E. Manly* and *Robert E. McKee* entered an appearance for intervenor American Telephone and Telegraph Company. *Durward D. Dupre* entered an appearance for intervenor Southwestern Bell Telephone Company.

Before: BUCKLEY, WILLIAMS, ROGERS, *Circuit Judges*

Opinion for the Court filed by *Circuit Judge WILLIAMS*.

*WILLIAMS, Circuit Judge*: Certain local exchange carriers ("LECs") challenge an order of the Federal Communications Commission on the ground that the Commission arbitrarily and capriciously disregarded its own rule when it denied "exogenous cost" treatment for cost increases that the LECs

experienced as a result of mandated changes in their accounting for certain post-retirement worker benefits. *Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employers Accounting for Postretirement Benefits Other than Pensions"*, 8 FCC Rcd 1024 (1993) ("OPEB Order"). We reverse and remand.

The concept of "exogenous costs" is an outgrowth (at least for regulatory purposes) of the Commission's decision to shift from conventional rate-of-return methods to the use of price caps for some of the firms subject to its rate regulation. Among the hopes for price caps is that they will improve incentives for innovation on the part of the regulated firms. Under rate-of-return regulation the Commission projects future costs on the basis of immediate past history, and sets rates calculated to recover such costs, with the result that a firm's only benefit from a cost-saving innovation is the advantage gained in the period before *new* rates become applicable—i.e., the firm enjoys additional profits only during the "regulatory lag". *National Rural Telecom Ass'n v. FCC*, 988 F.2d 174, 178 (D.C. Cir. 1993). With price caps, the initial base rates (here, the rates prevailing on July 1, 1990) are for the most part adjusted *solely* for reasons independent of the regulated firm's actual behavior, notably (1) an annual adjustment for general price inflation, measured by the Gross National Product Price Index ("GNP-PI"), see *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786, 6792-93 ¶¶ 47-54 (1990) ("LEC Price Cap Order"), *modified on recon.*, 6 FCC Rcd 2637 ("LEC Price Cap Reconsideration"), *further recon. dismissed*, 6 FCC Rcd 7482 (1991), and (2) an automatic annual downward adjustment for expected improvements in firm productivity, see LEC Price Cap Order, 5 FCC at 6793-6801 ¶¶ 55-119. The Commission also provided, however, for adjusting the price caps on the basis of "exogenous costs", which it described as "in general those costs that are triggered by administrative, legislative or judicial action beyond the control of the carriers." *Id.* at 6807 ¶ 166. Because of the carriers' lack of control, adjustments for such changes presumably do not undermine the price caps' incentive structure.

The Commission considered in advance quite a number of possible candidates for exogenous cost treatment, including, for example, changes in amounts paid or received under certain pooling arrangements, see LEC Price Cap Order, 5 FCC Rcd at 6807 ¶¶ 169-70, and, most pertinently here, changes in accounting rules. For accounting changes, it specified *automatic* exogenous cost treatment for changes made by the Commission itself in its Uniform System of Accounts ("USOA"), explaining that "such changes are imposed by this Commission and are outside the control of carriers." *Id.* ¶ 168; see also 47 CFR § 61.45(d)(1). It said, however, that changes in generally accepted accounting principles ("GAAP") ordered by the Financial Accounting Standards Board ("FASB"), were not to be the basis of automatic price cap adjustments, explaining:

As explained in the *Second Further Notice*, certain GAAP changes may require amendment to the USOA while others may not. Carriers must notify us of their intention to apply a change in GAAP and we will allow such change if we find it to be compatible with our regulatory accounting needs. No carrier may adjust its price caps to reflect a change in GAAP until we have approved the carrier's proposed change. Furthermore, we wish to clarify that no GAAP change can be given exogenous treatment until the Financial Accounting Standards Board has actually approved the change and it has become effective. The cap mechanism is intended to reflect changes in costs that have occurred, not anticipated cost changes.

LEC Price Cap Order, 5 FCC Rcd at 6807 ¶ 168 (footnotes omitted).<sup>1</sup> The treatment of GAAP changes thus appeared to

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<sup>1</sup> Readers may wonder why a change in accounting rules can be regarded as having changed real costs at all. No party discusses the point, and it is common ground that this feature is no obstacle to exogenous cost treatment for the changes at issue here. Certainly accounting changes may have material economic impact. A change in recorded earnings will change the company's price-earnings ratio, and thus possibly the market price of the stock.

differ from that of USOA changes only in that GAAP changes would originate in the FASB and would become mandatory in the pertinent sense only after the Commission found them, under its standard procedure, consistent with the agency's regulatory objectives. See 47 CFR § 32.16. For both types of accounting changes, the Commission's mandate brings about the change and demonstrates that the carriers lacked control. See also LEC Price Cap Reconsideration, 6 FCC Rcd at 2664-65 ¶ 63 (referring, for a GAAP change, to issue of "whether the change is outside the control of the carrier").

In a parallel proceeding relating to AT&T the Commission set forth a second criterion that a GAAP change would have to satisfy—a demonstration that the change "will not be double counted in the Price Cap Index, once in the GNP-PI and once as an exogenous cost." *Memorandum Opinion and Order on Reconsideration*, 6 FCC Rcd 665, 674 ¶ 75 (1991). And on reconsideration of the price order for LECs the Commission made clear that this second criterion also applied to them. See LEC Price Cap Reconsideration, 6 FCC Rcd at 2665 ¶ 63. Thus it appeared that changes in GAAP were to receive exogenous cost treatment if they were mandated by the Commission (the "control" test) and were shown not to involve double counting with the GNP-PI adjustment.

In December 1990 the FASB adopted Statement of Financial Accounting Standards-106 ("SFAS-106"), altering the way in which companies adhering to GAAP account for "other postemployment benefits" for fiscal years beginning after December 15, 1992. The "other", which explains the "O" in the OPEB acronym, is intended to exclude pension benefits: what is left generally consists of retirees' life insurance and medical and dental care benefits. Before SFAS-106, firms

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effectively altering the company's real cost of capital. But see National Economic Research Associates Study, Joint Appendix at 49-50 (citing econometric evidence that accounting changes generally have no effect on stock prices). In extreme cases, the accounting change may impose a binding limit on earnings available for payment of dividends or even push a marginal company over the edge into bankruptcy.

accounted for these benefits on a "pay as you go" or cash basis, recognizing them when the costs were paid rather than when the firm received the services for which the benefits were compensation. SFAS-106 adopts an accrual method, requiring recognition of OPEB costs as they are earned by current employees. See OPEB Order, 8 FCC Rcd at 1025 ¶ 3.

Besides requiring accrual treatment for *ongoing* OPEBs, SFAS-106 required businesses to recognize a *transition* benefits obligation, i.e., a reflection of the accumulated obligation accrued for work done in the past. Firms were to recognize this expense either all at once or to spread it out—either by using the average remaining service period of active plan participants or, if the average remaining service period were less than 20 years, by using a 20-year period. *Id.* at ¶ 4.

On application by Southwestern Bell, the Commission found SFAS-106 consistent with Commission objectives and authorized the LECs to adopt it on or before January 1, 1993. *Southwestern Bell*, 6 FCC Rcd 7560 (1991). Noting that the effect of recognizing the transition obligation immediately "would be so large as to seriously distort the carriers' operating results," the Commission directed the companies to amortize that obligation. *Id.* at ¶ 4.

In 1992 Bell Atlantic, US West, and Pacific Bell each filed tariff revisions which hiked their Price Cap Index ("PCI") levels and their rates to reflect the change wrought by SFAS-106 (i.e., the *increase* in their current-year OPEB costs over what they would otherwise have charged), asserting that these increments were exogenous costs. The Commission's Common Carrier Bureau suspended the tariffs and initiated an investigation into whether the LECs had demonstrated "that implementing SFAS-106 results in an exogenous cost change under the Commission's price cap rules". *Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employers' Accounting for Postretirement Benefits Other Than Pensions"*, 7 FCC Rcd 2724, 2725 ¶ 10 (1992). The Bureau noted that the order in *Southwestern Bell* authorized carriers to



adopt SFAS-106 "as a mandatory practice for purposes of the USOA [Uniform System of Accounts]." *Id.* at 2724 ¶3. Given the complex issues, the FCC made all LECs subject to price caps parties and requested them to submit information as to whether exogenous cost treatment should be accorded.

The Commission denied the claims for exogenous cost treatment, but used different rationales for the ongoing and the transitional elements. As to ongoing costs, it recognized that the accounting change was "not within the carriers' control", OPEB Order, 8 FCC Rcd at 1033 ¶53, but denied exogenous cost treatment on the ground that they had considerable "control over the present and future benefit plans they set with their employees and the costs of these plans". *Id.* As for the transitional obligation, the FCC skipped the control criterion and held that the LECs had failed to demonstrate that the effects of SFAS-106 were not already reflected in the GNP-PI adjustment. See *id.* at 1034-35 ¶¶61-66. It then went on to find that SFAS-106 failed to satisfy a number of hitherto unmentioned tests. The LECs filed the instant petition with us.

\* \* \*

Both sides agree that the FCC's statement of its criteria for exogenous cost treatment constituted a rule, not a policy statement. See, e.g., FCC Brief at 30-31, 32 n.31 (characterizing the issue as one of interpretation of the Commission's rules). Accordingly the Commission was bound to follow those statements until such time as it altered them through another rulemaking. See *National Family Planning v. Sullivan*, 979 F.2d 227, 231-32 (D.C. Cir. 1992). Compare *McLouth Steel Products Corp. v. Thomas*, 838 F.2d 1317, 1320 (D.C. Cir. 1988) (policy statements distinguishable as not establishing binding norms).<sup>2</sup> Thus the key question posed by petitioners is whether the FCC adhered to those criteria in evaluating the LECs' filings on SFAS-106. We conclude that it did not.

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<sup>2</sup> Of course the Commission would have to *explain* a deviation even from a policy statement. See, e.g., *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970).